

Self-Funded and Fully-Insured Health Insurance Plans: How Do They Differ?

Massachusetts Division of Health Care Finance and Policy

February 19, 2003

Summary: Interest in employer-sponsored health plans has grown since so little is known about plans that are funded by an employer. Self-funded or self-insured health plans are ones where the employer assumes the financial risk of covering its employees, paying medical claims from its own resources. A health plan is fully-insured if it is purchased from an insurance company or other underwriter that assumes full risk for medical expenses. Results from the 2001 Massachusetts Employer Health Insurance Survey demonstrated that large companies self-fund more often than small ones and the benefit packages for self-funded plans tend to be more generous even though the reason many employers self-fund is to save money. While this study represents only the beginning of the analyses of these plans, it seems that policymakers may not have to worry as much about lack of control over the plans since many self-funded plans offer adequate coverage.

Only federal laws and regulations govern self-funded plans even though state health insurance laws traditionally are more comprehensive. The federal Employee Retirement Income Security Act (ERISA) of 1974 exempts self-funded health plans from compliance with state laws and regulations including the submission of data to a state's Division of Insurance. Due to the lack of published data and state regulation, policymakers always are interested in learning more about self-funded health plans.

According to results from the 2001 Massachusetts Employer Health Insurance Survey, 17% of all private-sector Massachusetts establishments that offered health insurance self-funded at least one health plan. Employees in self-funded plans represented 30% of all employees in employer-sponsored plans.¹ Many employers that self-fund (especially smaller ones) purchase stop-loss insurance to limit risk exposure beyond a stated amount for either catastrophic loss on individual employees or group claims. The 2001 Massachusetts employer survey found that 52% of employers with self-funded plans purchased stop-loss insurance.

This analysis will examine employers' motivation for choosing to either self-fund or fully-insure health plans, and the factors that may relate to this decision, as well as the impact of the decision on health benefits and costs.

Methodology

As part of a federal grant¹ awarded to Massachusetts, the Division of Health Care Finance and Policy sponsored a telephone survey of private-sector Massachusetts establishments (single locations) regarding health insurance. The University of Massachusetts Center for Survey Research conducted the survey of over 1000 randomly selected private-sector establishments from April to November 2001. The sample was stratified by establishment size and included employers with at least two employees. Small establishments are defined as those with fewer than 50 employees while large establishments are defined as those employing 50 or more

¹ In September 2000, Massachusetts was awarded a State Planning Grant to develop viable options for providing access to affordable health insurance from the United States Department of Health and Human Services, Health Resources Services Administration.

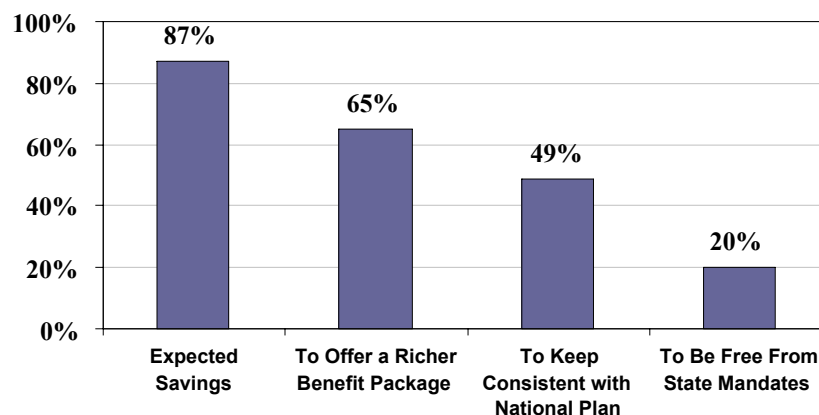
persons. Responses to survey questions were weighted to reflect the relative prevalence of that size establishment within Massachusetts. The survey included general questions as well as details regarding the employer's most popular plan (i.e., the plan with the largest number of members). Fifty-five percent of the establishments contacted responded to the survey.

Motivation for Self-funding

The 2001 Massachusetts Employer Health Insurance Survey included questions about self-funding to learn more about the extent of this practice and benefits provided, exploring how it differs from the fully-insured market. The survey also addressed an employer's motivation for choosing to self-fund its health plans. Employers that self-fund may be able to save money because they can limit the risk pool to their own employees, avoid state taxes on insurance companies' premium revenues, and have complete control over benefit packages and disease prevention/management programs.² In addition, some employers may self-fund to access claims data allowing employers "to understand the true costs of their health care plans and to tailor those plans accordingly."³

Whereas some experts argue that employers self-fund solely to avoid covering state mandates, Massachusetts survey results showed that the most common reason for self-funding was the expected savings overall, while being "free from state mandates" ranked fourth. However, some of the savings may be attributed to the fact that self-funded plans are not required to comply with state laws, including mandates (see Figure 1).

**Figure 1. Reasons Private-Sector
Massachusetts Establishments Gave for Self-Funding**



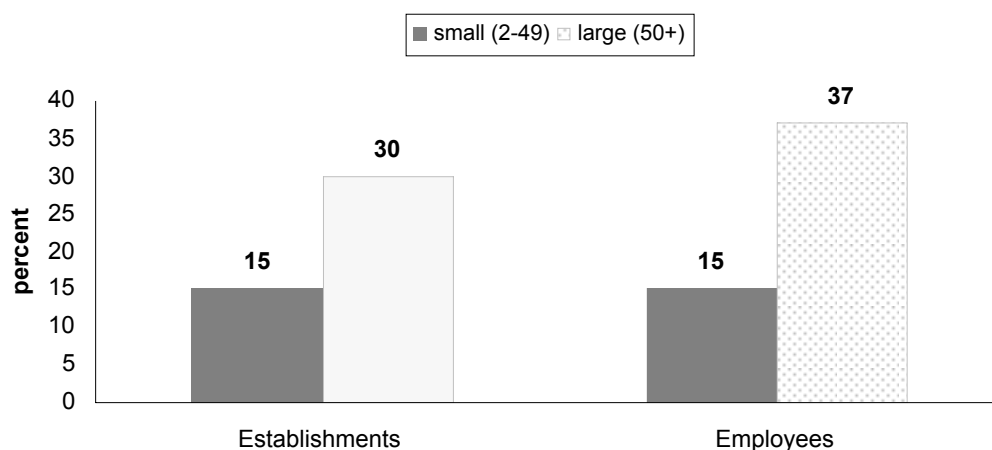
Source: Massachusetts Division of Health Care Finance and Policy,
2001 Employer Health Insurance Survey.

Size of Establishment

The size of an establishment (i.e., number of workers employed) is the most important indicator of whether an establishment decides to self-fund one or more of its health plans. Establishments with 50 or more employees (i.e., mid-to-large sized employers) self-fund at twice the rate of ones

with fewer than 50 employees (i.e., small employers) (30% vs. 15%) (see Figure 2). Employers with more employees are more likely to self-fund because the financial risk is spread across more employees and their budgets are large enough to absorb the risk. Among large establishments in Massachusetts, the percent with one or more self-funded plans increases with increasing size (i.e., 50-99: 17%, 100-249: 41%, 250+: 45%).

Figure 2: Self-Funding by Size of Establishment



Number of Plans Offered and Length of Time of Self-funding

Data from the Massachusetts employer survey found that whether an establishment self-funds has virtually no bearing on the number of health plans that establishment offers its employees. Instead, the size of an establishment is the most important indicator of the number of health plans it offers to employees, with smaller establishments offering fewer plan choices. Therefore, since there were approximately 153,624 small establishments with fewer than 50 employees and only 11,166 large establishments with 50 or more employees as of March 2000,⁴ the majority (77%) of establishments in the state that offer health insurance offer only one plan.

Almost two-thirds (62%) of establishments that self-fund have self-funded their most popular plan long-term (i.e., more than five years), while 22% have self-funded between one and five years. The remaining 16% of establishments had self-funded for less than one year.

Premiums

National studies have indicated a steep increase in health plan premium cost since the mid-1990's, with no sign of slowing. Monthly premiums for employer-sponsored health insurance have consistently risen during past years; in 1999 they rose 4.8%, they rose another 8.3% in 2000, another 11% in 2001, and in 2002 they rose 12.7%, significantly outpacing inflation.⁵ The Massachusetts employer survey found that some employers have responded to escalating premiums by increasing employees' out-of-pocket payments and in some cases increasing their share of premiums.

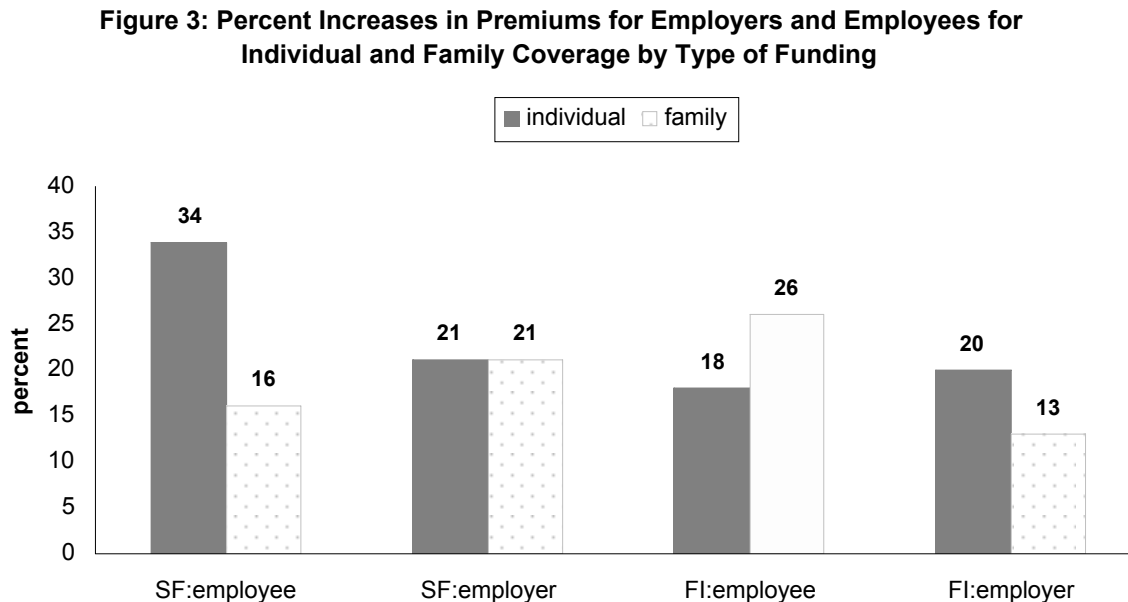
Differences in premiums between fully-insured and self-funded plans exist, though the differences are not always what was expected (i.e. premium cost for self-funded plans is not

always lower than for fully-insured plans). In 2001, the average total premium for individual coverage was higher for fully-insured plans than for self-funded plans (\$304 vs. \$277), whereas the average total premium for family coverage was generally higher for self-funded plans (\$692 vs. \$647). The average employee share of individual coverage was the same for self-funded and fully-insured plans (19%), but the average employee share of family coverage represented a higher percent for fully-insured plans than for self-funded ones (28% vs. 22%) (see Figure 3). The higher average employee share of the premium for family coverage under fully-insured plans might be a function of employer size, since smaller employers usually fully-insure their health plans and usually require employees to pay a higher percent of the premium. In Massachusetts from 2000 to 2001, the total premium for employer-sponsored individual coverage increased 23% on average for self-funded plans and 19% for fully-insured plans. For family coverage, the increases were 19% and 16%, respectively.

Employee contributions increased 34% for self-funded individual plans compared with 18% for fully-insured ones. In contrast, employee contributions increased only 16% for self-funded family plans and 26% for fully-insured family plans.

Employer contributions increased at similar rates for self-funded and fully-insured individual plans (21% and 20%). Employer contributions increased 21% for self-funded family plans compared with 13% for fully-insured ones.

Note: Premium data is based on the establishment's most popular health plan.



Copayments

The average copayments for physician visits, emergency department visits, and prescription drugs do not vary greatly based on whether a plan is self-funded or fully-insured. Slightly more fully-insured plans increased copayments for physician services (32% vs. 25%) in 2001, and

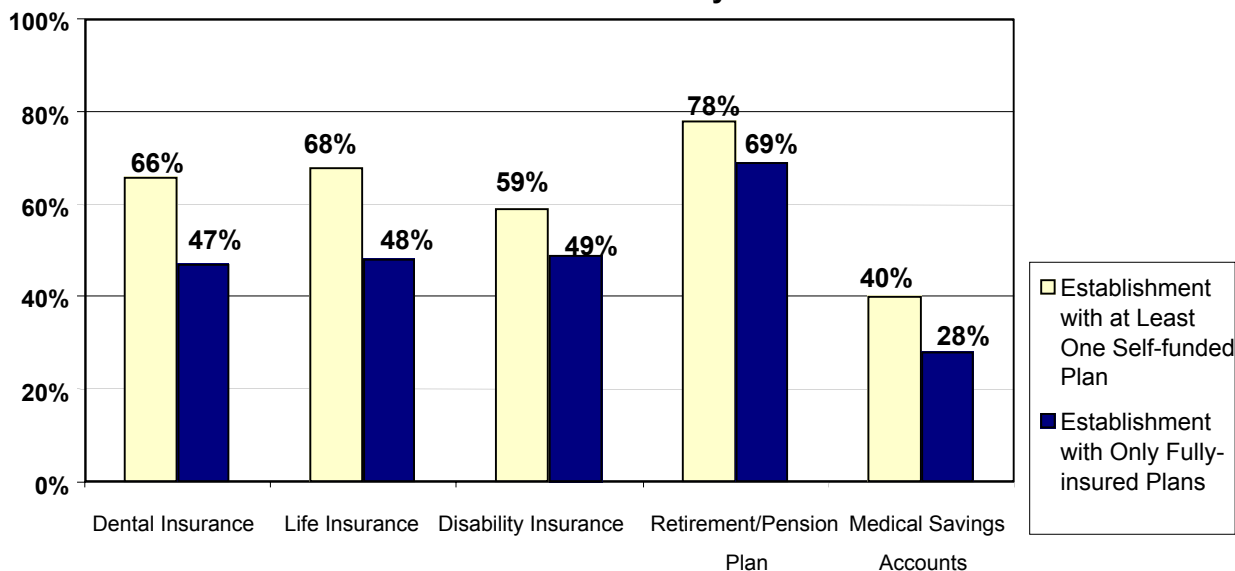
more than a third of both types of plans introduced new pharmacy copayment structures such as a three-tiered structure. A three-tiered structure means that drugs are separated into three categories with different copayments depending on how much a drug costs or whether it is on the health plan's formulary list.

Health and Other Benefits

On average, the survey results showed that Massachusetts establishments that self-fund are usually a bit more generous regarding benefits than those that fully-insure, even though self-funded employers are not required to comply with state laws and mandates for particular benefits. Both self-funded and fully-insured plans covered prescription drugs at approximately the same rate (94%). In addition, there was little difference in the extent of plan changes from 2000 to 2001 (i.e., increasing/decreasing benefits) between self-funded and fully-insured plans.

As shown in Figure 4, establishments that self-fund were more likely to offer employees other benefits in addition to health insurance, such as dental insurance or retirement/pension plans, which is probably a function of their greater size.

Figure 4: Benefits Offered by Establishments that Self-fund versus Fully-Insure



Source: Massachusetts Division of Health Care Finance and Policy, 2001 Employer Health Insurance Survey.

Conclusions

The survey results confirmed that the most important determinant of self-funding is employer size. Employers with 50 or more employees are much more likely to self-fund (30% self-fund) than employers with fewer than 50 employees. The likelihood of self-funding increases for employers with even more employees, for example, 45% of employers with 250 or more employees choose to self-fund.

This analysis also illustrates that the concern many policymakers have about self-funded plans being exempt from state laws and regulations may be unfounded since most self-funded plans' benefit packages are similar to those of fully insured plans.

Since so little is known about self-funded health plans and employers that self-fund, the 2001 Massachusetts employer survey represented a solid step toward bridging the information gap between self-funded and fully-insured plans.

Staff for this analysis:

John Cai
Elizabeth K. Robinson
Maxine Schuster

¹ 2001 MA Employer Survey Results: Graph and Table Compendium. www.mass.gov/hrsa

² Baker, Sharon, "Self-Funded HMOs on the Rise," Managed Care May 2002: 46D-H.

³ Ibid.

⁴ Massachusetts Division of Employment and Training, March 2000. Note: Totals include federal, state and local government and do not include the self-employed.

⁵ The Kaiser Family Foundation and Health Research and Educational Trust, Survey of Employer-Sponsored Health Benefits: 2001 Summary of Findings.